

# *Legal Update*

## **Amendment in Buy-Back Regulations-a better deal for Small Shareholders now!**

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The Companies Act, 1956 lays down stringent provisions under Section 77A, for *companies intending to purchase their own shares or other specified securities*, referred to as **“buy-back”** of securities. Additional compliances are required for the buy-back shares or other specified securities listed on any recognised stock exchange-compliances with the Regulations made by Securities and Exchange Board of India (SEBI). Thus, **SEBI (Buy-back of Securities) Regulations, 1998** were formulated to ensure greater transparency in the buy-back procedure for listed shares and specified securities. These Regulations were amended from time to time to suit the changing requirements of time. Latest amendment has come in the form of **SEBI (Buy-back of Securities) (Amendment) Regulations, 2012<sup>1</sup>** (referred to as the Buy-back Regulations) notified as on *February 7, 2012*.

An attempt has been made here to highlight the major changes that have been induced and bring out their implications:

### ❖ **INTRODUCTION OF THE CONCEPT OF “SMALL SHAREHOLDERS” IN THE CONTEXT OF BUY-BACK REGULATIONS:**

The Companies Act vests only “small” powers in the hands of **“small shareholders”<sup>2</sup>** by enabling them to proportionately represent themselves in the Board of Directors. No more privileges have been extended to them. The amended Regulations seek to fill up the vacancy.

Regulation 6 of the Buy-back Regulations allowed buy-back through tender offer from existing security holders on proportionate basis. *A new proviso has been inserted whereby it has been made mandatory to reserve higher of the following for small shareholders in case the Company opts to buy-back the shares/ other specified securities **through tender offer**:*

- *Fifteen percent of the number of securities which the company proposes to buy back; or*
- *Number of securities entitled as per the shareholding of small shareholders.*

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<sup>1</sup> The **SEBI (Buy-back of Securities) (Amendment) Regulations, 2012** is available at the given link: [http://www.sebi.gov.in/cms/sebi\\_data/attachdocs/1328613895121.pdf](http://www.sebi.gov.in/cms/sebi_data/attachdocs/1328613895121.pdf)

<sup>2</sup> Small Shareholder, as defined in this context in the Companies Act, means a shareholder holding shares of nominal value of twenty thousand rupees or less in a public company.

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In this context, the definition of “**Small Shareholders**”, as given under the amended Regulations is totally different under that provided under the Companies Act. “Small Shareholder” has been defined under newly inserted clause (1a) of Regulation 2(1) as

*“a shareholder of a listed company, who holds shares or other specified securities whose market value, on the basis of closing price of shares or other specified securities, on the recognised stock exchange in which highest trading volume in respect of such security, as on record date is not more than two lakh rupees.”*

In the year 2010, SEBI increased the maximum limit of investment by retail individual investors in an Initial Public Offer from Rs. 1 lakh to Rs. 2 lakh<sup>3</sup>. The stipulation of Rs. 2 lakh given under the definition of “Small Shareholders” as introduced in the amendment Regulations can be traced back to the enhancement in the limit made earlier.

As evident from Section 77A of the Companies Act, 1956, there are limitations on the quantum of buy-back that a company can resort to. Though the Regulations required the tender offer to be made on proportionate basis, the small shareholders had only a minimal proportion of shares eligible to be tendered. The amended Regulations fix a minimum level, which is to be reserved for small shareholders, so that they can have an easier exit route and that they can be placed in a better position than before, when compared to prominent shareholders.

### ❖ **DISPENSING WITH THE REQUIREMENT OF PUBLIC NOTICE:**

The Regulations, as amended, has dispensed off with the requirement of giving public notice stipulated earlier under Regulation 5A of the Regulations, in case the buy-back is for a maximum of 10% of the paid-up equity capital and free reserves of the company, made pursuant to a Board Resolution. Now, the only requirement is to file a copy of the resolution, with SEBI and the stock exchanges, where the shares or other specified securities of the company are listed, within two working days of the date of the passing of the resolution.

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<sup>3</sup> The limit was increased under SEBI (Issue of Capital and Disclosure Requirements) (Fourth Amendment) Regulations, 2010

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### ❖ **CHANGES PERTAINING TO PRE-OFFER PROCEDURAL FORMALITIES:**

The procedure relating to pre-offer period has been modified as follows:

- The Public Announcement for the buy-back through tender offer is to be made within *two working days* from the date of resolution. The time limit was not specified earlier.
- A copy of the public announcement along with the soft copy is to be submitted to the Board simultaneously through a merchant banker.
- A draft-letter of offer along with soft copy containing specified disclosures is to be filed with SEBI within *five working days* of the public announcement through a merchant banker who is not associated with the company. Earlier, the time allowed was seven working days.
- Before the amendment, the Regulations prohibited the despatch of letter of offer to the security holders before 21 days from the date of submission of the draft letter of offer and before the modifications, if any suggested by SEBI, are carried out. The amended regulations have shortened the timeline- now, SEBI is required to give its comments, if any, on the draft letter of offer not later than seven working days of the receipt thereof and in the event SEBI specifies any changes, the merchant banker to the buyback offer and the company are required to carryout such changes in the letter of offer before it is dispatched to the shareholders. In case SEBI seeks clarifications or additional information from the merchant banker to the buyback offer, the period of issuance of comments shall be extended to the seventh working day from the date of receipt of satisfactory reply to the clarification or additional information sought.
- The Public Announcement, as regards its contents, has been made all more comprehensive. The major requirements remaining the same, some of existing points have been deleted, as given below:
  - ✓ Offer details, total number and percentage of the total paid up capital and free reserves proposed to be bought back and price.
  - ✓ Proposed time table from opening of the offer till the extinguishment of the certificates.
  - ✓ Specified date for buy back.

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- ✓ Authority for the offer of buy back.
- ✓ Brief information about the company.

The new contents to be given in the public announcement are:

- ✓ Intention of the promoters and persons in control to tender shares/other specified securities indicating the number thereof , details of acquisition with dates and price.
- ✓ A confirmation that there are no defaults subsisting in repayment of deposits, redemption of debentures or preference shares or repayment of term loans to any financial institutions or banks.
- ✓ A confirmation that the Board of Directors has made a full enquiry into the affairs and prospects of the company and that they have formed the opinion-
  - that immediately following the date on which the General Meeting or the meeting of the Board of Directors is convened there will be no grounds on which the company could be found unable to pay its debts;
  - as regards its prospects for the year immediately following that date that, having regard to their intentions with respect to the management of the company's business during that year and to the amount and character of the financial resources which will in their view be available to the company during that year, the company will be able to meet its liabilities as and when they fall due and will not be rendered insolvent within a period of one year from that date; and
- ✓ In forming their opinion, the directors shall take into account the liabilities as if the company were being wound up under the provisions of the Companies Act, 1956 (including prospective and contingent liabilities);
- ✓ A report addressed to the Board of Directors by the Company's auditors stating that-
  - they have inquired into the Company's state of affairs;

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- the amount of the permissible capital payment for the securities in question is in their view properly determined; and
- the Board of Directors have formed the opinion on reasonable grounds and that the company will not, having regard to its state of affairs, will not be rendered insolvent within a period of one year from that date.
- The amendments in the buy-back regulations have necessitated certain changes in the format of the letter of offer so as to provide the requisite information about the Company such that the shareholders can make an informed decision of either retaining their stake or stepping towards exit gate. SEBI, vide Circular No. dated February 10, 2012<sup>4</sup> has introduced the **revised format of the letter of offer**. Major requirements of the standard letter of offer are:
  - ✓ Information contained in Letter of Offer to be as on the date of the Public Announcement (PA).
  - ✓ The source from which data / information is obtained should be mentioned in the relevant pages of Letter of Offer.
  - ✓ Financial data to be in terms of Rupees Lacs unless required otherwise (e.g. EPS). In case of financial data pertaining to an overseas entity, the rupee equivalent shall be disclosed in terms of Rs. Lacs and the basis of conversion to be disclosed. Data may also be disclosed in terms of the monetary unit applicable for the overseas entity, if so desired.
- Several responsibilities have been cast upon the Merchant Banker, besides the existing ones. The Merchant Banker is required to ensure the following:
  - ✓ Letter of Offer is presented in simple, clear and lucid language that is easily understandable.
  - ✓ Disclosures made in the Offer Document are complete and accurate and are in accordance with the Regulations.
  - ✓ The Letter of Offer with the tender form is dispatched to the eligible security holders not later than five working days from the receipt of communication of comments from the Board.

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<sup>4</sup>The relevant Circular is available at:

[http://www.sebi.gov.in/cms/sebi\\_data/attachdocs/1328787701952.pdf](http://www.sebi.gov.in/cms/sebi_data/attachdocs/1328787701952.pdf)

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- ✓ The date of the opening of the offer is not later than five working days from the date of dispatch of letter of offer.
- ✓ The offer for buy back is open for a period of ten working days.
- ✓ The Merchant Banker is required to submit the Due Diligence Certificate to the effect that the contents of the public announcement of offer as well as the letter of offer are true, fair and adequate and quoting the source wherever necessary, to SEBI along with the draft letter of offer.
- ✓ The Merchant Banker has to give the registration number of the Chartered Accountant who has given the report addressed to the Board of Directors of the Company, as a part of disclosures made under the Regulations.

#### ❖ **CHANGES IN THE OFFER PROCEDURE:**

The Offer Procedure has been totally modified as represented in the table below:

<b>Procedure under extant Regulations</b>	<b>Procedure under Amended Regulations</b>
<ul style="list-style-type: none"> <li>✓ Offer period was for a minimum of 15 days and a maximum of 30 days.</li> </ul>	<ul style="list-style-type: none"> <li>✓ A record date to be announced for the purpose of determining the entitlement and the names of the security holders eligible to participate in the proposed buyback offer</li> <li>✓ Offer period is 10 working days.</li> </ul>
<ul style="list-style-type: none"> <li>✓ Date of opening of offer not to be earlier than 7 days and not later than 30 days from the specified date.</li> </ul>	<ul style="list-style-type: none"> <li>✓ Date of opening of offer not to be later than five working days from the date of dispatch of letter of offer.</li> </ul>
<ul style="list-style-type: none"> <li>✓ Letter of offer to reach the security holders before opening of the offer.</li> </ul>	<ul style="list-style-type: none"> <li>✓ The letter of offer along with the tender form to be dispatched to the eligible security holders not later than five working days from the receipt of communication of comments from SEBI.</li> </ul>



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<b>Procedure under extant Regulations</b>	<b>Procedure under Amended Regulations</b>
<ul style="list-style-type: none"> <li>✓ In case the securities tendered by the security holders exceed the securities sought to be bought back, the acceptances per security holder to be on proportionate basis.</li> </ul>	<ul style="list-style-type: none"> <li>✓ Shares or other specified securities from the security holders to be accepted on the basis of their entitlement as on record date.</li> <li>✓ After accepting the shares or other specified securities tendered on the basis of entitlement, shares or other specified securities left to be bought back, if any in one category shall first be accepted, in proportion to the shares or other specified securities tendered over and above their entitlement in the offer by security holders in that category and thereafter from security holders who have tendered over and above their entitlement in other category.</li> <li>✓ The shares proposed to be bought back to be divided in to two categories; (a) reserved category for small shareholders and (b) the general category for other shareholders, and the entitlement of a shareholder in each category shall be calculated accordingly.</li> </ul>
<ul style="list-style-type: none"> <li>✓ Verification of the offers received to be completed</li> </ul>	<ul style="list-style-type: none"> <li>✓ Verifications of offers received and payment of consideration to those</li> </ul>





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<b>Procedure under extant Regulations</b>	<b>Procedure under Amended Regulations</b>
within 15 days of the closure of offer.	security holders whose offer has been accepted to be made or the shares or other specified securities to be returned to the security holders within seven working days of the closure of the offer

Therefore, we see that the amended Regulations intend to tighten the requirements relating to buy back, to provide greater opportunity to small shareholders in the buy-back offer keeping in view the principle of equitable treatment to all shareholders and ensure better disclosures before the security holders exit from the Company, with the ultimate objective of enhancing the efficiency in the buy-back process.